

# **BLUE RIBBON COMMISSION**

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## **PUBLIC RETIREMENT SYSTEMS**



**BRIAN J. CRALL**  
**CHAIRMAN**

**DECEMBER 2007**

# **BLUE RIBBON COMMISSION ON PUBLIC RETIREMENT SYSTEMS**

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Commission Chairman, Secretary Brian J. Crall

Governor Ernie Fletcher appointed the 24-member Blue Ribbon Commission on Public Employees Retirement Systems to study methods to address the current unfunded liabilities accrued by the Kentucky Retirement Systems and the Kentucky Teachers' Retirement System, including pension and medical insurance benefit benefits. Over eight months, the commission endeavored to develop a plan to enable the Commonwealth and the retirement systems to fulfill the Commonwealth's obligation to current retirees and employees while examining the appropriate level of benefits for future employees. This plan must be presented to the Governor no later than January 8, 2007.

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# I. FORWARD

To the Citizens of the Commonwealth:

This report serves as synthesis of more than eight months of work by the Blue Ribbon Commission on Public Employees Retirement Systems. It attempts to distill the presentations, independent reports, expert and public testimony and meeting discussions given to or conducted among the Commission and its three ad hoc Work Groups (all of which are contained on the media disc which serves to append this report).

As this commission concludes its work, it is imperative that I recognize the significant contributions made on the part of many:

- Governor Fletcher who saw a critical need and put together a diverse group of Kentuckians representing public employees, public employers, public pension systems, private citizens, investment experts and fiduciary experts to examine these issues in as transparent a way as possible and come up with recommendations to present to the Commonwealth's public policy makers.
- The members of the commission who gave much time and attention to understanding the nuances of a very complicated subject and the differences between two very different systems. Despite the deep differences of opinion among many on the commission, the deliberations were, almost without exception, thoughtful and constructive.
- The appointed and visiting legislators who showed their support and interest in the many deliberations of the commission on behalf of the constituents they represent.
- The LRC and its staff for graciously hosting each of the commission's many meetings. The venue and the accommodations were proved most helpful.
- The many dedicated citizens and advocates who attended each meeting and followed the work of the commission with great attention and interest.
- The appreciable contributions of our two biggest retirement systems and their Executive Directors, Bill Hanes (KRS) and Gary Harbin (KTRS).
- The exceptional work of the administrative staff from the various Cabinets who supported the commission; especially Becky Parrish, Tom Ferree and Jill Midkiff.

Few of the recommendations are new ideas. In many cases they represent previously and often discussed issues; including but not exclusive to full funding of annual contributions, pre-funding COLAs when granted, longer working careers before accessing unreduced retirement benefits, and constant vigilance in managing the myriad forces driving increases in health insurance costs.

Solutions, both short and long term, are well within reach. However, they will require courage and sacrifice on behalf of all parties.

It is the hope of the Commission that this report, its recommendations and the manifold hours of deliberations it summarizes provides a helpful platform and framework for decisive, effective and appropriate actions by elected and appointed leaders in ensuring the quality and controlling the costs of Kentucky's public employee retirement benefits.

Respectfully Submitted,



Brian J. Crall  
Chairman

## II. INTRODUCTION

Governor Ernie Fletcher established the Blue Ribbon Commission on Public Employees Retirement Systems by Executive Order 2007-114 in February 2007. The “Commission” was created to study methods that would address the current unfunded liabilities of the Commonwealth’s retirement programs, exclusive of the Judicial and Legislative retirement systems. At the center of this study was the commitment to fulfill the promises made to current retirees and employees and to responsibly plan for the future by ensuring appropriate levels of benefits are available for employees that have yet to come into the systems.

Kentucky’s public employee retirement systems account for over 445,000 lives within our Commonwealth. Combined, these systems represent stakeholders of the largest employer in over half of Kentucky’s counties and at least among the top in the remaining counties. Their sustainability is paramount with broad and profound implications from both a beneficiary and taxpayer perspective.

The Kentucky Retirement Systems (KRS) administers three separate funds, the Kentucky Employees Retirement System (KERS), the State Police Retirement System (SPRS) and the County Employees Retirement System (CERS). The Kentucky Teachers’ Retirement System (KTRS) administers the certified employees in primary, secondary and post-secondary schools. All of these systems administer “qualified,” defined benefit retirement plans for public employees and teachers under Section 401(a) of the Internal Revenue Code. Defined benefit plans pay benefits to retirees based upon a formula. The formula used to compute benefits in both KRS and KTRS provides participating members with a guaranteed lifetime payment or an actuarial refund lump sum payment (not in KTRS) at retirement based on the number of years of service, average salary and a multiplying factor.

Both KRS and KTRS are funded by three sources: employee contributions, employer contributions, and investment income. Unfortunately, the payment of the Commonwealth’s contributions to KRS at less than the actuarial required contribution (ARC) for more than a decade, representing over \$1 billion shortfall has

lead to a period of lower funding levels in the KRS pension fund. The borrowing by the Commonwealth of contributions that would have gone to the KTRS pension fund, but that have been allocated to pay current years' medical insurance costs instead have reduced funding levels in the KTRS pension fund. The exponential growth in the Commonwealth's medical insurance benefit costs, driven largely by medical inflation, benefit compensation and utilization, also brings Kentucky to a period of lower funding levels in the medical insurance funds. Couple this with the overlay of GASB rules 43 and 45, which was implemented by the retirement systems in 2006, and the result has been to produce a post employment medical insurance trust with higher levels of unfunded liabilities. There are a variety of factors, actuarial assumptions and methodologies that impact the level of funding required to maintain the retirement systems' financial condition.

The Commonwealth is not unique in having a large and growing unfunded liability in its public employees' retirement system. Further, any discussion of unfunded liabilities must be understood in context. Most retirement systems are experiencing better funding for pension systems after market disruptions over the last 5-7 years and benefit enhancements in the late 90's created growth in unfunded liabilities as reported in a recent GAO report. However, many public retirement systems that administer post retirement medical insurance benefit for retirees are challenged with attaining and maintaining appropriate funding levels while attempting to comply with the new GASB 43 and 45 accounting rules for same. Add to this certain specifics germane to Kentucky such as a fortified inviolable contract for existing employees and retirees, a rich retiree medical benefit, a history of benefit enhancements and an unfunded Cost of Living Adjustment (COLA) in KRS, and Kentucky's funding position is eroding even more, while producing higher payments for public employers.. At risk is the Commonwealth's credit rating, availability of government services or worse, solvency of the plans if the wrong response is employed. Employee and retiree advocate groups understandably argue the Commonwealth has a fiduciary responsibility to the plan participants and are appropriately sensitive to not changing plan benefits. This must be weighed against the Commonwealth's fiduciary responsibility in ensuring solvency of the plans.

The impact of the current situation is perhaps best evidenced in the significant financial impact that the increase in unfunded liabilities has had on the employers within the County Employees Retirement System (CERS). Unfortunately, that impact is projected to worsen over the next few years. In FY 2003 local governments paid 6.34 percent of a non-hazardous duty employee's salary and 16.28 percent of a hazardous duty employee's salary to CERS. Those rates respectively increased to 16.17 percent and 33.87 percent in FY 2008. Actual CERS employer contributions increased more than five times the rate of inflation in the two prior years. This is irrespective of CERS employers making the full ARC payment as required by statute and the Board of Trustee's action to allow CERS agencies to phase to the full rate over a 5 year period.

Although a recent revision in the projected medical insurance benefit cost trend led the KRS Board of Trustees to significantly decrease the CERS employer contribution rates, while slightly reducing the phased in rate, at their November 2007 meeting, rates will likely continue to climb through FY 2018. According to Cavanaugh Macdonald, the FY 2018 CERS employer contribution rates are projected to increase to 23.51 percent for non-hazardous duty and 46.29 percent for hazardous duty.

These substantial increases — which have already led many local governments to cut personnel, raise taxes, spend rainy day funds, and/or cut services — will force CERS employers to make substantial budget cuts throughout the next decade.

Those closest to the retirement systems as well as budget managers at all levels of state and local government have advised of and forecasted the current status for several years. It has been the recent emergence of two recent changes from the Governmental Accounting Standards Board (GASB) that has brought the painful message for all stakeholders into clearer view and perspective.

While compliance of GASB is not a legal requirement, it serves as a uniform accounting and reporting standard that the public and bond rating agencies follow as a measurement of an agencies financial health, GASB statements 43 and 45 (Other Post Employment Benefits - OPEB) now require the full

disclosure and accounting for healthcare benefit costs in plan and state financial reports, similar to the way public defined benefit plans have reported for pensions for many years. OPEB is predominately composed of future healthcare benefits promised to employees and retirees, which are separate from the pension benefit. Prior to the implementation of GASB 43 and 45, these healthcare benefit costs or liabilities (OPEB), were routinely treated as a “pay-as-you-go” expense and were not reflected in the financial statements. KRS, however, has advanced funded medical insurance benefits for many years, but not at the GASB 43 and 45 level. KRS and KTRS have both reported their unfunded healthcare benefit liabilities based on similar criteria as GASB 43 and 45 for many years. The GASB changes result in a more accurate financial statement depiction of the liability and in turn require a real and increased budgetary response. This is most clearly illustrated in the revelation that the current OPEB unfunded liability for the state retirement systems totals \$17.6 billion, which is almost 62% of the \$28.4 billion total unfunded liability. Of course, the funding of same is expected to reduce these unfunded liabilities over time, like a home mortgage, considering too that OPEB has only recently been implemented.

Another variable impacting the Kentucky situation is the nature and breadth of the “inviolable contract” between the Commonwealth’s retirement systems and its current existing employees and retirees. Kentucky is one of a few states that have an inviolable contract to provide both pension and healthcare benefits to its retirees. The body of law that defines and supports this “contract” is argued to be among the strongest, most clearly delineated in the entire country. Several Kentucky Attorney General opinions and at least one Kentucky Supreme Court case (Jones v. KRS Board of Trustees) have addressed the inviolability of Commonwealth’s contract. Given that, under the prevailing understanding of Kentucky’s inviolable contract, benefit levels cannot be reduced with respect to any current employee or retiree, the immediate solution set is constrained to focusing on controlling costs, increasing contributions and maximizing investment income.

All near term cost control options require that the Commonwealth establish a plan to fully fund the systems at the actuarial required contribution (ARC). In doing so, the Commonwealth can ensure that it is fulfilling its fundamental fiscal duty to address the liability. Another component of a near term solution



set is a significant capital infusion or “pre-funding” instrument which could take the form of a bond issuance, the essence of which has been analyzed by the Commission and is attached. While such a debt instrument carries risk and should be appropriately sized and thoroughly analyzed prior to any serious consideration, it also offers the potential for strategic relief in the form of utilizing maximum discount rates, and ensuring the lowest possible actuarial required contributions (ARCs). It should be noted that a bond instrument is not an answer by itself but can be part of a viable solution set.

Further analysis has identified the COLA as a significant exacerbating factor in regard to the KRS unfunded liability. This COLA is statutorily required (though not part of the inviolable contract) but not pre-funded, thus driving up the unfunded liability by more than \$300 million every year since the legislature has not decided to exercise its authority to alter, reduce or eliminate, as it can. This benefit has been a focus of considerable discussion in the Commission’s study. In KTRS, a fixed COLA of 1.5% is built into the contribution rates and any additional “ad hoc” must be approved and funded by the General Assembly and Governor during each state budget cycle.

Investment strategy, especially in times of under funding, must be appropriately aggressive but still in line with the risk tolerance levels and retiree payroll demands of the specific plan. Restrictions on the plans’ asset allocation have been reduced over the past several years allowing the funds to diversify asset classifications so as to be increasingly performance based or move toward a more total return focus. An examination of universal industry best practices and the proposal of an investment review have been brought before the Commission. Such a study would be necessary to provide the guidance that would be prudent before proposing any enhancements to current investment philosophy. It should be noted that neither the Commission nor Wilshire has engaged in any analysis of best practice or appropriateness of investment processes related to any of the retirement systems administered in Kentucky.

Another component of a potential solution set would likely include a reasonable modification of retirement benefits (pension and medical insurance) for new hires. Employee advocates appropriately caution against recommending extreme changes for any new hire plan, citing the inarguable value of attractive

retirement benefits as a critical variable in employee recruitment and retention. At the same time, tax payer advocates caution against resistance to any changes in retirement benefits for new hires as such action would serve to preserve the conditions currently driving the growth in the UAL and impacting the actuarial soundness of the retirement systems. Of necessity, changes of this nature would phase in over a generation and thus offers no quick solution or silver bullet.

The Commonwealth needs and bond rating agencies have stated they are looking for, a comprehensive plan that incorporates near and long term solutions to adequately address the growth in liabilities confronting the retirement systems. A successful plan would be multi-faceted and implemented in a deliberate and phased approach, including some level of pre-funding, a commitment to fully fund the ARC, and reasonable changes in retirement benefits to address the growth in liabilities. Again, this cumulative approach is consistent with the expressed expectations of the bond rating agencies, who understand that overnight success in this journey is not realistic—that attaining optimal funding levels can only reasonably be obtained over several years as a result of sustained and steady progress. These agencies have commended Kentucky’s early efforts to bring stakeholders together to examine this issue in open forum.

It should be noted that the retirement systems, through legislative and administrative instruments, have executed a significant number of key “fixes” in recent years and should be commended for their foresight in this regard. Nonetheless, much remains to be done in addressing the challenge these mounting liabilities present for our Commonwealth. A balance must be struck between the attractiveness and sustainability of the pension benefits offered to public employees through the various systems. No easy answers exist.

In summary, the Commission was faced with three primary questions to consider: How can the Commonwealth fulfill its obligations to current employees and retirees? What is the appropriate retirement package for future public employees? How do public employers pay for both? These questions were the basis for the methodology employed in the Commission’s study and helped frame the explicit

subjects of the three subcommittees' (Work Groups) efforts. A detailed examination of the recommendations and conclusions of the workgroups and the Blue Ribbon Commission follows in this report. The recommendations provided by this Commission are respectively submitted to the Governor and to the State Government Committees and the Appropriation and Revenue Committees of the Kentucky General Assembly for their consideration.

### III. REVIEW OF PUBLIC RETIREMENT SYSTEMS

#### **Kentucky Retirement Systems (KRS)**—*as submitted by Kentucky Retirement Systems*

The Kentucky Retirement Systems (KRS) administers retirement benefits for more than 316,000 state and local government employees. These employees include state employees, state police officers, city and county employees, local agency employees, and non-teaching staff of local school boards and regional universities.

KRS administers three plans: the Kentucky Employees Retirement System (KERS); the County Employees Retirement System (CERS); and the State Police Retirement System (SPRS)

#### **Plan Administration**

A nine-member Board of Trustees administers the systems. The trustees are elected, appointed or serve *ex officio* as follows:

- Two trustees are elected by KERS members
- Two trustees are elected by CERS members
- One trustee is elected by SPRS members
- Three trustees are appointed by the Governor
- The Secretary of the Kentucky Personnel Cabinet serves *ex officio*.

The Board appoints an Executive Director, who acts as the Chief Administrative Officer of the Board.

KRS reports to the Kentucky General Assembly and Governor.

#### **KRS Plan Type**

The three systems administered by KRS are *Qualified Public Defined Benefit Plans*, established under Section 401(a) of the Internal Revenue Code.

Defined Benefit plans pay pension benefits based on a formula, while Defined Contribution plans (such as a 401(k) plan) pay benefits based on contributions and earnings on those contributions. The KRS statutory benefit formula at full retirement is the following:

$$\text{Final Compensation} \times \text{Compensation} \times \text{Benefit Factor} \times \text{Years of Service} = \text{Annual Benefit}$$

In the above formula, “Final Compensation” is the average salary used to determine benefits at the time of retirement. The “Benefit Factor” is a percentage based upon the system, the type, the timing of the member’s service and the retirement date. “Years of Service” is the current service, prior service, purchased service, and sick leave (if the agency participates) that has been earned by the member.

### **KRS Assets and Benefits Payments**

As of June 30, 2007, KRS assets total \$17.37 billion dollars. KRS pays \$1.4 billion dollars in pension and medical insurance benefits each year. Ninety-six percent (96%) of the benefit payments are delivered to Kentucky residents and have a significant impact on the Kentucky economy.

### **Retirement Eligibility**

#### **Non-Hazardous Members (Normal Retirement)**

Normal retirement is at age 65 or older. At age 65 or older, with at least one (1) month of service credit, the member may elect to receive a benefit for life that is an actuarial equivalent to twice the member’s contributions and interest. At age 65 or older with at least 48 months of service credit, the member is eligible to receive an unreduced benefit for life based on the formula.

#### **Non-Hazardous Members (Early Retirement)**

A member may retire early with 27 or more years of service credit regardless of age and receive an unreduced benefit for life. A member may retire early with 25 years of service credit regardless of age and receive a reduced benefit for life. A member who is at least age 55 with 5 or more years of service credit may retire early and receive a reduced benefit for life.

**Hazardous Members (Normal Retirement)**

Normal retirement is at age 55 or older. At age 55 or older, with at least one (1) month of service credit a hazardous member may elect to receive a benefit for life that is an actuarial equivalent to twice the member's contributions and interest. At age 55 and older with at least 60 months of hazardous duty service credit a member is eligible to receive an unreduced benefit for life based on the formula.

**Hazardous Members (Early Retirement)**

A hazardous member may retire early with 20 years of service credit regardless of age and receive an unreduced benefit for life. A hazardous member may retire early at age 50 with 15 or more years of service credit and receive a reduced benefit for life.

**Medical insurance Benefit**

The medical insurance benefit was created by the Kentucky General Assembly in 1978 and was made a contractual obligation of the systems in 1988.

KRS provides group rates on medical insurance and other managed care coverage for retired members. Participation in the insurance benefit is optional. KRS provides access to medical insurance coverage through the Kentucky Employees Health Group Health Plan, which is administered by the Kentucky Personnel Cabinet, until a recipient reaches the age of 65 or becomes Medicare eligible. Once a retired member becomes eligible for Medicare, coverage is available through a self-insured plan offered by KRS. A retired member's spouse and/or dependents may also be covered through medical insurance provided by KRS.

**Benefits for Members Participating Prior to July 1, 2003**

KRS pays a percentage of the monthly contribution rate for medical insurance coverage for the retiree based on the retired member's years of service. A portion of the contribution for the family is paid based on the number of years of service in a hazardous duty position. The percentage of the monthly contribution rate paid is shown in the following table for hazardous and non-hazardous members:

<b><u>Years of Service Credit</u></b>	<b><u>% Paid</u></b>
At least 4 years but less than 10 years	25%
At least 10 years but less than 15 years	50%
At least 15 years but less than 20 years	75%
20 or more years	100%

100% of the monthly contribution is paid for medical insurance for a retired member in a non-hazardous or hazardous position who is totally disabled from any employment as a result of a duty-related injury regardless of actual service. In the case of a hazardous member, 100% of the monthly contribution is paid for medical insurance for the member's spouse and dependents if the member is disabled as a result of a duty-related injury, regardless of actual service. 100% of the monthly contribution is paid for medical insurance for the spouse and dependent children of a hazardous or non-hazardous member who dies as a result of a duty-related injury regardless of the deceased member's service.

#### **Benefits for Members Participating After July 1, 2003**

For a member whose participation began on or after July 1, 2003, eligibility for insurance benefits is not provided until the member has earned at least one hundred twenty (120) months of service in KRS. Non-hazardous members whose participation begins on or after July 1, 2003 will earn a contribution for insurance of ten dollars (\$10) per month for each year of earned service. Hazardous members will earn a contribution of fifteen dollars (\$15) per month for each year of hazardous service earned. The monthly insurance contribution will be increased annually by the change in the Consumer Price Index (CPI), not to exceed 5%. The annual increase is cumulative and continues to accrue as long as an insurance contribution is payable to the retired member or beneficiary. Upon a hazardous retiree's death, the spouse will receive a monthly contribution of ten dollars (\$10) per month for each year of hazardous service, provided the spouse is designated as beneficiary and remains eligible for monthly benefits.

## How KRS is Funded

There are three (3) sources of funding for Kentucky Retirement Systems:

- Employee contributions, which are set by statute.
- Employer contributions, which are set annually by the KRS Board of Trustees based on an independent actuarial valuation and recommendation. The employer contribution rate consists of a pension contribution and a medical insurance contribution.
- Investment return.

Historically, the percentage of funding provided by these three sources is as follows:

- Employee contributions 16%
- Employer contributions 20%
- Investment return 64%

These percentages are consistent with public pension fund revenue sources nationally.

The KRS Investment Committee has the authority to make investment decisions and hire external investment managers and consultants. KRS utilizes internal investment staff, external investment managers, and independent investment consultants to conduct the investment program. For the past ten year period, the KRS pension fund has returned an average of 8.9% and the insurance fund has returned 8.6%

According to at least one source, Strategic Investment Solutions (SIS), an independent investment consulting firm: *"KRS should be quite proud of its historical returns. It has significantly outperformed the Total Fund benchmarks for both plans, at a lower level of risk over most periods, while remaining competitive with its public fund peers."* Memo from SIS, 3/23/07. In addition to providing investment returns in excess of established benchmarks, KRS has carefully controlled its investment expenses. A 2005 study by CEM Benchmarking, Inc. of 268 pension funds, rated KRS as a "High Value Added & Low Cost" system.



## **KRS Plan Funding Levels and Unfunded Actuarial Liabilities**

A pension plan's "funding level" is the ratio of its actuarial assets to its actuarial liabilities. The funding level is a measure of the plan's financial soundness and provides a "snapshot" of the plan's ability to meet liabilities (benefits) earned to date. The funding levels of KRS's pension funds have steadily declined since 2001. For example, in 2001, the KERS non-hazardous pension fund had a funding level of 125.7% based on the actuarial value of assets and liabilities. As of June 30, 2007, that funding level had dropped to 56.9%. Likewise, the CERS non-hazardous pension fund had a funding level of 146.3% in 2001 and, as of June 30, 2007, the funding level of that fund had dropped to 82.1%. The KRS funding levels of the KRS insurance funds have also declined.

A pension plan's unfunded actuarial liability (UAL) is the difference between the actuarial value of assets and liabilities. It represents liabilities on benefits already earned by employees and retirees, which are amortized over a 30 year period. The amortization payment on the UAL is a part of the employer contribution rate. As of June 30, 2007, the combined unfunded liabilities of KERS and SPRS (hazardous and non-hazardous) were \$9.53 billion dollars and the combined unfunded liabilities of CERS (hazardous and non-hazardous) were \$5.26 billion dollars.

## **Causes of the Declining Funding Levels and Increased Unfunded Liabilities**

### **Contribution Shortfalls in KERS and SPRS**

For 9 of the last 15 years, the Commonwealth has failed to contribute the actuarially recommended employer contribution rate to the KERS and SPRS systems. This has resulted in a shortfall of \$1.3 billion dollars in contributions and investment income over those years in the two systems.

### **Cost Inflation for Retiree Insurance**

Inflationary increases in retiree insurance costs have had a significant negative impact on the systems. In 2005, for example, there was a 43.4% increase in the cost for single coverage in the Kentucky Employees Health Plan. In 2006, the increase was 19.3%. In 1978, when the medical insurance benefit was created, the cost of single coverage was \$25.50 per month. During the 2007 plan year, the cost of

single coverage was \$457.70 per month. The monthly cost for single coverage has more than doubled in just the past 8 years from \$214 per month to \$458 per month. The drastic increase in medical insurance costs have been a significant reason for the decline in plan funding levels and the increases in unfunded liability.

### **Government Accounting Standards Board (GASB) Statements 43 and 45**

In 2006, the Government Accounting Standards Board (GASB) issued statements 43 and 45, which changed the accounting and reporting requirements related to Other Post Employment Benefits (OPEB), including medical insurance. KRS must now recognize and report on an accrual basis the cost of retiree medical insurance benefits over the working life of the employee. Compliance with these statements was a primary reason for the drastic decrease in funding levels and increase in unfunded liabilities of the systems from July 1, 2006 to July 1, 2007.

### **Benefit Enhancements**

The benefit enhancements made over the past 20 years have added greatly to the liabilities of the systems and have had a major impact on the funding of the KRS systems.

### **Examples of Some Recent Benefit Enhancements**

- **1990** Non-Hazardous Benefit Factor from 2.0 to 2.2% (CERS only)
- **1990** "27 Years and Out" for Non-Hazardous becomes effective
- **1990 and 1992** School Board participation requirements were reduced to 80 hours per month for a majority, then all employees
- **1996** Retiree Cost of Living Adjustment (COLA) with no pre-funding
- **1998** CERS Hazardous high-three
- **1998** KERS 2.2% benefit factor with 20 years service
- **2000** School Board Employees receive 12 months service credit for 9 months work
- **2001** High-three window for KERS and CERS Non-Hazardous

## **Retiree Cost of Living Adjustments (COLAs)**

In July each year, a recipient's retirement allowance is automatically increased by the average annual increase in the Consumer Price Index for All Urban Consumers (CPI-U) for the most recent calendar year, unless the Kentucky General Assembly reduces or eliminates the COLA. By statute, the COLA is not allowed to be pre-funded. Therefore, each COLA becomes a new unfunded liability for a 30 year amortization period. As an example, the 3.4% COLA that became effective July 1, 2006 added approximately \$310 million dollars to the unfunded liability of the systems. The annual amortization payment on this COLA was estimated to be \$15.5 million dollars.

According to Cavanaugh Macdonald, the KRS Actuary:

*"...the [KRS] pension rates are increasing because of the annual cost of living adjustment (COLA)." Statement of Tom Cavanaugh, KRS Actuary, at November 16, 2006 KRS Board of Trustees meeting.*

*"...each COLA generates a negative cash flow in the early years followed by a positive cash flow later, exactly the opposite of what advanced funding would provide. This cash flow difference means fewer dollars to invest currently, lower investment returns, and higher employer costs over the long term than advanced funding the COLAs..." Statement in a March 22, 2007 letter from Cavanaugh Macdonald to KRS*

## **2000 – 2002 Market Losses**

During the period 2000-2002, KRS, like all other persons and entities invested in the equities markets suffered losses or significantly reduced investment returns. For example, during 2001, the KRS pension funds suffered a loss of 5.4% and the insurance funds lost 3.8%, while the assumed rate of return was 8.25%. Although KRS uses a five year actuarial smoothing method (under the smoothing method, 20% of a market gain or loss in any year is accounted for each year for five years, which helps to minimize the

annual impact of such losses), these market losses had a very large impact on system funding levels and the system unfunded liabilities.

### **What Action Has Already Been Taken to Address KRS Funding Issues?**

In 2003, the KRS Board completed an extensive review of plan features and offered several considerations to the Legislature as it relates to benefits for future employees. Many of these options for new hires were implemented into law by **HB 290** (2004 GA). Savings from these changes were estimated by KRS staff to amount to \$2.25 billion dollars realized over a 20 year period as current employees are replaced by new employees covered under the new benefits provisions.

### **2004 Changes:**

- Employees hired on or after July 1, 2003 earn medical insurance benefits based upon dollar value (non-hazardous: \$10/month for each year of actual service and hazardous: \$15/month for each year of actual service).
- Service purchases after 8/1/2004 do not count towards vesting for medical insurance benefits.
- Service purchases made by new hires after 8/1/2004 will not count towards vesting for retirement eligibility.
- The service purchase factor methodology was reviewed and amended in 2005 so that members pay the full actuarial cost for service purchases.
- 2006 Actuarial Experience Study that modified actuarial assumptions related to retiree health premium increases, retirement rates, and life expectancies will increase rates

## **Kentucky Teachers Retirement System Overview**—*as submitted by Kentucky Teachers*

### *Retirement System*

#### **Established**

The Teachers' Retirement System of the State of Kentucky (KTRS) was created by the Kentucky General Assembly in 1938, and funded in 1940. KTRS is governed by Chapter 161 Section 220 through Chapter 161 Section 990 of the Kentucky Revised Statutes, and is a cost-sharing multiple-employer defined

benefit plan established to provide pension benefit plan coverage for local school districts and other public educational agencies in the state.

### **Uniqueness of KTRS**

KTRS is unique when compared to other public pension plans in that most members are not subject to Social Security withholding, there is a fixed employer contribution rate set by statute, retiree health care benefits are provided, and the base cost of living adjustment (COLA) of 1.5% is pre-funded. Ad-hoc COLAs, if awarded, are funded in the biennial budget process.

### **Board of Trustees**

KTRS is governed by a nine-member board of trustees. Seven of the nine members are elected by the membership and are comprised of four active member trustees, one retired member trustee, and two lay trustees who are not members of the retirement system and typically have backgrounds in finance. The remaining two trustees are the State Treasurer and the Commissioner of the Kentucky Department of Education who both serve in an ex-officio capacity.

### **Participants**

As of June 30, 2007, a total of 198 employers participated in the plan. Employers are comprised of 175 local school districts, 17 Department of Education agencies and other educational organizations, 5 universities, and the Kentucky Community and Technical College System. Among the active contributing members as of December 2006, there are 44,269 vested members with 0-26 years of service, and 14,004 vested members with 27+ years of service. There are 15,042 active members who are substitutes, part-time or retired-return-to work. There are also 16,642 inactive members and 39,332 retirees and beneficiaries currently receiving benefits. Total membership was 129,289 in December of 2006.

Within the KTRS membership, the average career educator began teaching at age 27 and retires at age 56 with 30 years of service. The educator is then eligible for a lifetime pension that is equal to 75% of his or her final average salary, and also receives a medical benefit that is funded on a pay-as-you-go basis.

### **Vesting/Calculation of Retirement Benefits**

Members become vested when they complete five years of credited service. To qualify for monthly retirement benefits, payable for life, members must either: (1) attain age 55 and complete at least 5 years of Kentucky service, or (2) complete 27 years of Kentucky service. Participants who are at least age 55 and retire before age 60 with less than 27 years of service are subject to an actuarial reduction in the calculation of their retirement benefits.

The general benefit formula is: years of service x multiplier x average of 5 highest salaries. The multiplier for non-university service is 2.0%/2.5%/3.0% (for new hires after July 1, 2002, every year is 2.0% until they accumulate 10 years of service credit at which point every year becomes 2.5%---the 3.0% multiplier is available only for qualified years in excess of 30). Participants who are at least age 55 and have 27 years of service credit use their highest 3 salaries in the general benefit formula. The university service multiplier is 2% for all years.

### **Disability/Life Insurance**

The System provides disability benefits for vested members at the rate of 60% of the final average salary for a period of 5 years, at which point the disability allowance is recalculated with the standard service retirement formula using the additional 5 years of service credit. There are regular medical reviews to ensure that the physical/mental conditions remain disabling. A life insurance benefit, payable upon the death of a member, is \$2,000 for active contributing members and \$5,000 for retired or disabled members.

### **Contribution Rates**

Contribution rates are established by Kentucky Revised Statutes. Members are required to contribute 9.855% of their salaries to the System. University members are required to contribute 8.375% of their salaries. KRS 161.580 allows each university to reduce the contribution of its members by 2.215%; therefore, the university members contribute 6.16% of their salary to KTRS. University members also

contribute to Social Security. If a member leaves covered employment before accumulating 5 years of credited service, accumulated member contributions plus interest are refunded to the member upon the members' request.

The employer contribution rates are 13.105% for non-university members and 13.84% for university members.

Three-quarters of one percentage point (.75%) of both the member contribution and the employer contribution is deposited in the KTRS medical insurance fund.

### **Post-Retirement Health Care Contributions**

The post-retirement healthcare provided by KTRS was implemented in 1964 and is financed on a pay-as-you-go-basis. In order to fund the benefit, 1.5% of the gross annual payroll of all active members is contributed. Of this amount, one-half is derived from member contributions and one-half from employer contributions. Also, the premiums collected from retirees help to meet the medical expenses of the plan. To continue funding through 2008, the Commonwealth will borrow \$289 million from the KTRS Pension Fund. There is an urgent need for medical insurance funding to be included in the state's General Fund budget, rather than borrowing from the KTRS Pension Fund.

### **Post-Retirement Health Care Benefits**

In addition to the required pension benefits, KRS 161.675 allows KTRS to provide post-retirement healthcare benefits to members and dependents. To be eligible for medical benefits, the member must have retired either for service or disability, attain age 55 with 5 years of Kentucky service, or had 27 years of Kentucky service.

KTRS insurance for its members is provided in two plans:

- Kentucky Employees Health Plan (KEHP) for retirees under age 65.

- Medicare Eligible Health Plan (MEHP) for retirees age 65 and over and for retirees/spouses who have Medicare coverage because they are receiving Social Security Disability.

The KEHP includes school district employees, state employees, some local government employees, teacher retirees under age 65 and state, county and city retirees under age 65. The plan moved to self-insurance in 2006.

The MEHP, which has been a self-insured plan since 1992, consists of two components – medical benefits, administered by Humana, and drug benefits, administered by Medco. In January 2007, the MEHP moved to a Medicare Advantage Private-Fee-For-Service plan that mirrors the self-insured plan.

#### **KTRS Major Efforts to Contain Healthcare Costs**

- 1992 – Implemented self-insured plan for retirees
- 2001 – Eliminated double dipping of medical benefits
- 2002 – Medical insurance benefit reduced for new hires
- 2006 – Implemented Medicare Prescription Part D Plan - \$10 million annual savings
- 2007 – Implemented Medicare Advantage Private-Fee-For-Service Plan - \$11 million annual savings

#### **KTRS Major Efforts to Contain Retirement Costs**

- 1998 – Air-time purchases at full actuarial cost.
- 1998 – High 3 at age 55 with 27 years of service.
- 2002 – Return-to-work salaries limited after required breaks-in-service.
- 2002 – Limit on number of retirees that can return full-time.
- 2002 – Benefit multipliers lowered for new hires.
- 2002 – Field of membership significantly expanded.
- 2002 – Disability retirement reformed.
- 2004 – Service credit purchases moved to full actuarial cost.



## **Investments**

KTRS invests to preserve the assets of its membership and to generate income to meet its actuarial assumed rate of return. Approximately one-half of the investment portfolio is managed internally by trained and experienced staff that hold at a minimum Chartered Financial Analyst certification. The other one-half of the investment portfolio is managed externally by professional money or asset managers. The performance of the money or asset managers, as well as the overall investment strategy of the retirement system, is routinely evaluated by an investment consulting firm with a nationally stellar reputation. In addition, KTRS has engaged another independent investment consultant to audit the performance of the standing investment consultant as an added layer of review. KTRS routinely meets or beats its benchmarks and keeps its investment expenses among the lowest in the nation.

## **Actuarial Status of the System**

The KTRS Pension Fund is actuarially sound; however, borrowing from the Pension Fund to sustain retiree medical insurance impacts actuarial soundness. At June 30, 2006, the pre-funded pension fund had assets of \$14.86 billion and liabilities of \$20.33 billion, for an unfunded liability of \$5.47 billion, or 73.1%. The pay-as-you-go medical fund had assets of \$131.6 million and liabilities of \$4.34 billion, for an unfunded liability of \$4.21 billion, or 3%.

## **KTRS Positive Impact**

### **For Members:**

- Provides retirement security for those who have devoted their careers to education.
- Retired educators do not have to worry about their retirement savings being depleted because they are guaranteed a lifetime pension.

### **For School Districts:**

- Provides a benefit to attract and retain quality teachers.

- When teachers retire, positions become available for new teachers and promotions become possible for current teachers.
- When teachers retire, payroll costs are reduced when new teachers replace retiring teachers.
- There are over 14,000 active members of KTRS who are currently eligible to retire. When they retire and are replaced with the average starting salary for new KTRS members, a savings of \$315 million per year will be realized for school districts and other KTRS employers.

**For State & Local Economies:**

- Each month, KTRS distributes \$91 million in retirement annuity benefits and \$14 million in medical benefits.
- Retired teachers have a significant economic impact in every county in Kentucky since 93% of KTRS retirees continue to live in Kentucky following retirement.
- Member and employer contributions pay for only approximately 4.5-5.5 years of an average retiree's retirement. Income earned by KTRS on its investment portfolio pays for the remaining 20+ years of the average retiree's retirement.

**Kentucky Public Employees' Deferred Compensation Authority Overview—as**

*submitted by Kentucky Public Employees Deferred Authority*

The Authority was established in 1975 by Kentucky Revised Statute (18A.230-275). Plans are administrated by the Authority, under the direction of a Board of Trustees. All plans have received written approval by the Internal Revenue Service. All funds are held in trust for the exclusive benefit of plan participants. Plan documents are able to be modified (amended) in an expeditious manner. A 7-member Board of Trustees has the ultimate responsibility for the administration of the Authority.

**Plans currently offered:**

A Plan established under and in accordance with Internal Revenue Code Section 401(k) (401 (k) Plan), including a Roth 401(k) option as well as deemed IRAs (both Traditional and Roth). A Plan established

under and in accordance with Internal Revenue Code Section 457. 401(k) Plan provides for an employer match program.

**Eligibility:**

Automatically eligible:

All employees of Kentucky state government, public colleges and universities as well as public elementary and secondary schools

Also eligible upon completion of Employer Joinder Agreement:

All employees of cities, counties, public libraries, public water districts and other eligible public subdivisions (i.e. Kenton County Airport Board)

Eligibility to participate is immediate upon employment. There are no waiting restrictions or open enrollment periods.

Participation as of June 30, 2007:

Employers – 811

Participants – 70,227 (state-26,857; education-20,884 and other 22,486)

Total assets – \$1.5 billion (approx.)

Total annualized deferrals (approx.) – \$113 million

Total payouts (unaudited) 2006 – 8,929

Total payout dollars (unaudited) 2006 – \$89 million (approx.)

**Funding structure:**

All costs are borne by the participants. The total average annual participant fee is 0.77%. **No** state tax dollars are used in support of the Authority's plans. There are no costs to any employer, other than minimal payroll processing expenses or the employer's share of a matching contribution under the 401(k) Plan. Due to the design of defined contribution plans such as what the Authority administers, there are no unfunded employer liabilities. In fact, the Authority maintains an administrative cash reserve

(approximately 1 year of expenses) in the unlikely event current year revenues are inadequate to pay current year expenditures.

**Investment options:**

1 stable value fund and 27 no-load mutual funds (Vanguard, Fidelity, T. Rowe Price, etc.), including 5 age-based life cycle funds. Investments may be either self-directed or employer directed.

**Plan features:**

Loans are currently available, but may be restricted at employer/plan level. Financial

Hardships/Unforeseeable Financial Emergencies are currently available, but may be restricted at employer/plan level, as well.

## **IV. BRC APPROACH & METHODOLOGY**

Governor Fletcher empanelled the Blue Ribbon Commission on Public Employee Retirement Systems by Executive Order 2007-282 for the sole purpose of studying current unfunded liabilities of the Commonwealth's retirement programs, excluding Judicial and Legislative, and developing recommendations to restore the systems to optimal funding levels. The twenty-four (24) member Commission was attached to the Finance and Administration Cabinet for administrative purposes and was made up of sixteen (16) members that represented the leadership levels of Executive branch, Legislative branch and public employee retirement interests. In addition to these stakeholders, the Governor appointed eight (8) citizen members that possessed expertise in the areas of investment matters and institutional fund management, matters of fiduciary duty, and the highest level of business administration experience. Finance and Administration Secretary John R. Farris originally presided over the Commission as Chairman, but upon his resignation from state government was succeeded by the vice-chairman, Brian Crall, Secretary of the Personnel Cabinet.

The Commission began its work in April of 2007 with the charge to deliver its recommendations on issues and policies to the Governor and to the State Government Committee and to the Appropriations and Revenue Committees of the Kentucky General Assembly by December 1, 2007.

The approach of the full Blue Ribbon Commission was intended to serve as a public forum for education and discussion on matters of universal importance pursuant to the Commission's original charter such as: retirement systems orientation, stakeholder interests, matters of legal opinion, as well as budget and actuarial concepts and analysis

The full Blue Ribbon Commission was granted the authority to hire outside consultants where necessary. Two (2) contracts were awarded by a competitive bid process and in compliance with state procurement statutes under KRS 45A—one for legal interpretation and opinion on the inviolable contract (Morrison and

Foerster, LLP) and one for benefit consulting services (Gabriel, Roeder, Smith and Company). In addition, the Commission also benefited from the services of the retirement systems actuarial consultants, Cavanaugh Macdonald Consulting, LLC.

The full Blue Ribbon Commission was further subdivided into three (3) informal Working Groups along the following lines of study; *plan financing strategies*, *pension benefit strategy*, and *healthcare benefit strategies*.

Work Group 1 was comprised of nine (9) members and chaired by State Budget Director Brad Cowgill. This work group was tasked with examining the state's financial liabilities and sought answers to the Governor's question; how should the Commonwealth fulfill its obligation to current employees and retirees. The group convened five meetings over seven months in delivering its recommendations.

Seven (7) members made up Work Group 2, which set out to determine the appropriate level of pension benefits to attract and retain future public employees. Chairman Brian Crall lead this work group's efforts in the study of benefits currently available, comparisons of benefits to other employers and surrounding states and the Commonwealth's ability to sustain those benefits going forward. Work Group 2 met on six occasions. In its final deliberation, it met to take-up recommendations from GRS and those recommendations previously presented by the Chair. Work Group 2 adopted one recommendation regarding COLA. The balances of the recommendations were forwarded to the full BRC with no formal action.

Work Group 3, chaired by Health and Family Services Cabinet Secretary Mark D. Birdwhistell, analyzed medical insurance benefits available to current employees and retirees and sought to compare them against similar benefits offered in other jurisdictions and against the value of those mandated by the Kentucky Kare standard of 1994. The goal was to develop recommendations to provide sustainable employment and post employment health benefits for current and future public employees. Work Group 3

met on six occasions in working toward review and referral of recommendations for the full Blue Ribbon Commission.

All Work Groups were granted access to the full services of the larger Blue Ribbon Commission and its resources as well as the Commission's contracted legal, actuarial, and benefit design subject matter experts. While the intent of the Working Groups was to derive a focused list of recommendations by subject area, it was the full Blue Ribbon Commission that served as the venue for final deliberation, in essence a clearinghouse, in tendering a consolidated recommendation on behalf of all Working Groups. The Work Groups were also intended to allow for maximum transparency, stakeholder involvement and interested party feedback.

The full Blue Ribbon Commission convened eight meetings during the course of its proceedings and was governed by all applicable open meetings laws and administered under generally accepted parliamentary procedure. The public was invited to speak and register their concerns at all full Blue Ribbon Commission meetings as well as all Work Group meetings.

A complete archive of all full Blue Ribbon Commission Meeting agendas, minutes and artifacts have been compiled and provided for in the Appendix section in multi-media format. These materials were also made available on the Blue Ribbon Commission's website during the entire life cycle of the Blue Ribbon Commission.

## V. INVIOABLE CONTRACT

When analyzing the state's inviolable contract, the legal opinion makes a distinction between pension benefits and medical benefits. In regard to pension benefits, the existence of an inviolable contract seems clear. However, while KRS and KTRS are clearly covered by the scope of the inviolable contract for pension and medical insurance benefits, [-] KTRS coverage for medical insurance benefits is limited to access only. It is less clear regarding the scope of medical benefits protected and, to date, there is no Kentucky case law on point.

"The Kentucky statement of intent is one of the strongest among the states. Its statute expressly states that pension benefit laws "constitute an inviolable contract of the Commonwealth and the benefits provided therein shall ... not be subject to reduction or impairment by alteration, amendment, or repeal." See, e.g., KRS 16.653, 61.692, 78.852.. Thus, under Kentucky law, pension benefits for public employees and retirees are a contractual right, and those benefits may not be reduced or terminated by the legislature retrospectively.

With respect to medical benefits, there is a split of authority among the states on the issue whether medical insurance or other medical benefits are part of the retirement benefit conferred by public retirement systems. However, the Kentucky statutes provide that medical benefits are included as part of the "inviolable contract" of the Commonwealth with regard to KRS participants, with the exception that benefits "provided to a member whose participation begins on or after July 1, 2003, shall not be considered as benefits protected by the inviolable contract." See., KRS 61.702(8)(d). The extent to which the Kentucky legislature may modify the medical benefits that are presently conferred by statute to employees hired before July 1, 2003, has not been determined by the Kentucky courts. To the extent that the inviolability exists relative to post employment medical insurance, it is clear by related statutes in KRS Chapter 18A that it does not extend beyond the value of the Kentucky Kare Standard Plan of 1994.



## **VI. WORKING GROUP FINDINGS**

### **Work Group 1: Financing Strategy**

#### **Defining a Strategy to Fulfill Our Commitments to Existing Employees and Retirees**

*Secretary R. Mike Burnside, Chair*

Both KRS and KTRS are funded by three sources: employee contributions calculated as a percentage of their annual pay, employer contributions originating from state and/or local appropriations provided in an enacted budget, and investment income. Actuaries have concluded that the assets of the Commonwealth's retirement systems are insufficient to fund the stream of benefits already owed to existing employees and retirees. This work group was chartered to examine these unfunded liabilities and devise strategies to meet the state's obligation to current employees and retirees.

#### **Background**

As stated above, unfunded actuarial accrued liabilities result when asset valuations do not cover the accrued liabilities. This can be caused by a number of things such as;

1. Granting initial benefits or granting benefit increases for service already rendered.
2. Actual experiences are worse than actuarial assumptions:
  - a. higher salaries
  - b. earlier retirement dates
  - c. lower death rates
  - d. lower rates of investment earnings
  - e. lower rates of non-death terminations
  - f. higher costs of benefits
3. Lower plan contributions than required.

A number of these factors have contributed to the unfunded actuarial accrued liabilities in the Commonwealth's retirement systems. One thing specific to KRS is the year-to-year impact of the statute on the cost-of-living-adjustment (COLA). This is granted every year but is not part of the financing assumptions. Thus in years when the COLA is granted, the cost, gets added to the liability of the system. Further, it's obvious if you earn less than what is anticipated by the discount rate you will have a higher unfunded accrued liability a year later. Finally, the Commonwealth has not made the contributions actuarially necessary to KERS and SPRS over the last 4-5 budget years to accommodate this adjustment and such shortfall in dollars significantly adds to the unfunded accrued liability for those systems. Likewise, the Commonwealth has decided to borrow monies from the KTRS pension trusts in order to pay what is necessary to pay current medical insurance benefits to retirees.

**Figure 1.**  
**Unfunded Liability by System** June 30, 2007 Actuarial Valuation

Retirement System	AAL Unfunded Liability in millions		
	Pension	Health	Total
KTRS	5,970	5,788	11,758
KERS – NH	4,089	4,580	8,669
CERS – NH	1,191	2,374	3,565
CERS – H	569	1,133	1,702
KERS – H	92	253	345
SPRS	199	317	516
<b>Total</b>	<b>12,110</b>	<b>14,445</b>	<b>26,555</b>

The Kentucky Retirement Systems (KRS) consists of three retirement systems: KERS, CERS, and SPRS. Kentucky Teachers Retirement System (KTRS) makes up the fourth retirement system reviewed by this commission (Legislative and Judicial are not subject to this directive). KERS and CERS are subdivided into non-hazardous and hazardous employees and have separate benefit structures. Each retirement system administers both a pension fund and a health [an] insurance fund that provide the beneficiary with a retirement monthly allowance and retiree health insurance benefit respectively.

It is prudent in proposing any solution set to a given problem to understand the basis of that problem. Therefore, an examination of a few actuarial and retirement plan concepts is required.

There are three policies that drive any retirement plan: a *benefit policy*, an *investment policy* and a *funding policy*. All three policies are inter-related; one can not be looked at in isolation. Considerations and recommendations taken up by Work Group 1 all fell along one of these three lines.

The *benefit policy* answers the question “How Much”, “When”, and “To Whom” benefits are paid. Statutes comprise the answers to this question. The inviolable contract that exists within the Commonwealth between its plan and the employees, severely limits any modifications in this area that would reduce benefits with respect to existing employees and retirees.

The second is the *investment policy*. This component looks at what asset classes to invest in and in what proportion (allocation). Both of the KRS and KTRS systems have written investment policies that are reviewed on an annual basis and in more detail, periodically by investment consultants, to get them to the right mix for risk and return. A retirement plan is reaching maturity when the real engine is the investment return engine, as opposed to the contribution engine. It is therefore important for a plan to meet its investment benchmarks and to be in the right asset allocation to get optimal returns—this is the cheapest way to pay for any benefit structure.

The *funding policy* examines the “How Much” and “When to Contribute” aspects of a retirement plan. Through an annual actuarial valuation conducted each year, the liabilities that exist for the current active and retired members in the funds are determined (as of June 30<sup>th</sup> of each year) and from those liabilities, calculations are made to determine what contributions are needed to properly fund for benefits in the future. A goal for each plan is to identify a set of actuarial methodologies that will generate a contribution that is level as a percentage of payroll from year-to-year to assist in the budgeting process. This total employer contribution rate is comprised of a contribution to each respective pension and medical insurance trust fund.

Figure 2.

**Basic Retirement Funding Equation**

$$C + I = B + E$$

(C = contributions; I = investment income; B = benefits paid; E= expenses/administration)

There are fundamentally two different methods of financing retirement benefits; “Pay-as-you-go” assumes the current generation pays benefits for the prior generation. This is basically what is happening to Social Security right now. The recent application of GASB Statement 43 and 45 requirements are moving plans away from this method to one of an advanced or pre-funded plan design related to medical insurance provided to retirees. It should be noted that KRS medical insurance has been advanced funded for many years.

Fortunately, most public employee retirement pension systems are of this “save-as-you-go” approach or advanced funded design. However, the funding of medical insurance benefits have primarily been of the “pay-as-you-go” variety for most state and local retirement systems. While, KRS has historically advanced funded at some level , KTRS health insurance benefits were established by the General Assembly in 1964 on a pay-as-you-go basis only ~~[has not]~~. The lack of advanced funding for medical insurance benefits for retirees constitute the principal reason for the increasing unfunded liabilities confronting employers.

**Work Group 1 Considerations and Recommendations**

Addressing the unfunded liabilities given the constraints of the inviolable contract, tightening state and local budgets, escalating healthcare costs related to new accounting standards and annual COLAs that are not advance funded requires the formulation of a phased, multi-faceted plan. There is no “one” single source that has enough power to entirely solve the funding of the benefits under the Commonwealth’s public retirement systems.

The rationale for phasing a multi-faceted solution is based on the fact that currently the sufficient funding to remedy the problems simply does not exist today. Credit rating agencies understand that it is impossible to believe that any state or public entity can implement an overnight remedy. These entities are less concerned about the extreme velocity of a fix and focus rather on the soundness of a deliberate and disciplined plan that will address the UAL and comply with GASB 43 and 45. The Commonwealth has been commended for the job it has already done in implementing some changes to address the UAL as well as creating a focus group (the Commission) to study and devise a larger plan.

A second reason to phase an approach is that it ensures a proposed solution does not “over dedicate” resources. With the implementation of several concurrent recommendations, it is fiscally responsible to leverage current resources in the most efficient way possible. Phasing permits forward progress in a manner that allows for constant measure and calibration of the plan and its effects.

#### *Benefit Policy*

From a benefit policy perspective, the inviolable contract largely limits any creation of financial help from a new benefit policy to prospective employees. The goal in adding a new hire retirement plan is to ultimately reduce the normal cost of the plan and thus position its funding requirements within a sustainable level for the Commonwealth. Kentucky is one of only a few states that currently offer a 100% health benefit to its retirees. Reducing the consumption of pre-65 retirement health benefit would have a tremendous impact on plan cost. Additionally, encouraging a longer working career for public employees benefits the Commonwealth by retaining the experience and talent of a more seasoned workforce. Additional opportunities exist with regards to COLAs, [hybrid DB/DC] plan designs and calibrating other post employment benefits.

Challenges exist, however, in balancing the appropriate plan change with maintaining a competitive benefit that is necessary to attract and retain good candidates. Caution must also be exercised to ensure that any defined contribution element does not create an excessive migration out of younger, new

entrants from the defined benefit plan. Doing so would significantly increase the recurring current cost to the employer of the legacy defined benefit plan.

Work Group 2 largely focused and took the lead on all studies pertinent to any pension benefit policy adjustments. Recommendations of this variety are found within that report.

### *Investment Policy*

In an environment of under funding, efforts to optimize the investment strategy is paramount. Investment return is the most powerful component in a mature retirement plan. To this end, Work Group 1 has recommended that in order to achieve the greatest returns possible, given an acceptable risk tolerance, the plan's investment strategies should be studied by independent outside parties. This recommendation was made without any examination of the current investment policies and strategies, governance or operational practices or other best practices of the retirement systems and is not the result of any criticism or discovery of the systems. Focus areas of a study should include an assessment of all current governance as well as operational practices in comparison with accepted industry best practices. Work Group 1 recommends best practices as prescribed by Wilshire Consulting, to serve as the basis for this comparison study.

### *Funding Policy*

Historically inadequate funding levels for Kentucky's Public Retirement Systems have played a significant role in defining today's current UAL situation. Additionally, some would argue that GASB statements 43 and 45 have brought a more accurate depiction of this status into full view, considering that the medical insurance obligations, like pension, are permanent and, in Kentucky, contractually promised. It is unreasonable to expect that current conditions, left unchanged, could provide for the funding that is actuarially required under these statements. Opportunities should therefore be examined to create greater investment leverage. A capital infusion into the systems' insurance funds would attain a more acceptable level of funding the plans, which in turn may allow the Commonwealth to use a higher discount rate in its actuarial assumptions. This event would in turn reduce the required ARC computation.

An option to provide this capital infusion which Work Group 1 forwarded for consideration of the Blue Ribbon Commission is the issuance of a OPEB bond to cover a portion of the plan.

There are explicit market risks associated with such an option (lower than expected returns on proceeds or an unfavorable bond market at issuance), not to mention a compromised flexibility in transferring a “soft” debt to a hard, balance sheet liability. This option would also require an increased debt service discipline on the part of the Commonwealth.

Work Group 1 has recommended further analysis of this option from benefit consultant, Gabriel, Roeder Smith and Company, with an issuance amount of \$ 1 billion and a \$ 1.5 billion.

## **Work Group 2: Pension**

### **Detailing the Appropriate Level of Pension Benefits to Attract and Retain Future Public Employees**

*Secretary Brian J. Crall, Chair*

The ability to attract and retain a modern educated work force is critical to the success of any employer, public or private. Pension and post employment benefits often play an important role in prospective employee’s evaluation of current job opportunities and future career path. This work group will examine the needs for future employees for security and flexibility in planning for retirement in the context of the commonwealth’s ability to sustain those benefits going forward. The time allotted for the Blue Ribbon Commissions work did not allow for a comprehensive review of the policy issues in competition between public and private employers for skilled or non-skilled labor.

## **Background**

The Commonwealth of Kentucky greatly values the service of its public employees and nothing exhibits this more than the fact that current active members and retirees of Kentucky's public employee retirement systems arguably enjoy some of the richest, most attractive benefit formulas and retirement eligibility features in the country.

Unfortunately, what makes these defined benefit plans so attractive and competitive with peer public and certainly private plans is what also contributes to an environment that renders the declining position in which these systems now find themselves.

The work group began its efforts by asking the KRS, KTRS and Deferred Comp systems to educate the Work Group in regard to their operations and what they offer employees and retirees. Work Group 2 also asked for input from public employers as to the impact of these benefits on their organization and heard from outside groups (the Chamber and the Coalition for Sustainable Benefits) regarding their perspective on employee pension benefits.

Benefit consultant Gabriel Roeder Smith & Company, undertook to analyze and compare the pension benefits provided through KRS and KTRS against each other. KTRS was found to generally have more provisions that contained the cost drivers. Next, Kentucky pension benefits were compared to our surrounding states and other comparator states to determine which, if any, current benefits serve as outliers.

This analysis found that KY's COLA, both in amount and in its unfunded nature (KRS only), to be outside the norm. Additionally, it found that Kentucky's 27-and-out feature was a liberal and costly retirement eligibility feature when compared against other states (the norm seemed to be a "Rule of 85") and resulted in some of the shortest careers in present-day economies.



The analysis revealed that KY's final average salary computation is very liberal, effectively equating to a high 25 months instead of a high three years or a high 49 months instead of a high five years. Kentucky was also found to have very costly "spiking features" used to calculate a final salary and determine pension benefits. The spiking features are inclusive of terminal pay (annual and comp time payouts upon separation from state government) and the use of accrued sick leave to be applied toward years of service. It was generally agreed by the Work Group that the "spiking features" needed to be eliminated from the computation of final salary in any "new hire" plan.

Finally, it was determined that Kentucky's broad application of the Hazardous Duty class of employee is much more liberal than our comparator states and public employers. Under current plan design, too many classifications of employees qualify. Many suggest that such a category should be predominantly limited to Police and Fire.

The analysis found that both plans had only moderate numbers of issues to really address that have not already been so in previous legislation and administratively in order to help mitigate the UAL and that any changes in new hire plans (given that the inviolable contract precludes any substantive changes to the plans for current employees and retirees) would not appreciably manifest financially for a decade.

One of the strongest and most frequently stated realities brought to light during Work Group 2's deliberations was the need to have employees working longer and drawing pension and medical insurance benefits later in life. This approach of increasing the length of a state worker's career not only aides in the cost containment effort in that it provides for less consumption of pre-65 healthcare retirement benefits, but it ends a policy that robs the Commonwealth of critical years of service by some of the most experienced and knowledgeable resources the state has to offer.

Additional options [~~opportunities~~] exist for new entrant plan designs with regards to COLA's, hybrid DB/DC plan designs and calibrating other post employment benefits. Challenges exist, however, in balancing the appropriate plan change with maintaining a competitive benefit that is necessary to attract

good candidate. Caution must also be exercised to ensure that any defined contribution element does not create an excessive migration out of younger, new entrants from the defined benefit plan. Doing so would significantly increase the cost of the legacy defined benefit plan.

## **Work Group 2 Considerations and Recommendations**

The following recommendations were presented to the Work Group for consideration and are distilled from suggestions by members of the public as well as members of the Commission:

- Expand the Board of both KRS and KTRS by two additional appointed members and require those new members to have professional experience in the area of private investment, funds management, or private sector pension funds.
- Require investment and fiduciary training for all Board members (KRS and KTRS).
- Extend service requirements to 32 years (retain service purchase options, if purchased at full actuarial value) before qualifying for unreduced pension benefits (KRS and KTRS).
- Require a “rule of 87” (at least 32 years of service and age 55) to qualify for unreduced pension benefits (KRS and KTRS).
- Eliminate “separation of employment” payouts (annual leave and/or “comp” time) counting toward the computation of final salary and pension benefits (KRS and KTRS).
- Create a “Career Average Payment Plan” to better align ultimate benefit computations with career benefit contributions (KRS and KTRS).
- Change COLA to a pre-funded fixed percentage of 1.75% payable, as “13<sup>th</sup>” check payable in 1/12 installments each month and only in years when the trust fund’s percentage of funding exceeds 80%. Increase to 2% if the trust fund’s percentage of funding exceeds 90% and 2.25% if the trust fund’s percentage of funding exceeds 100%. In the case of “mixed service” employees, the COLA will be set at a level of the trust fund with the lowest percentage of funding of the various systems that comprise the employee’s mixed service (KRS and possibly KTRS).

- For new hires, change the eligibility for health coverage to those that are “Medicare eligible” for the cash premium assistance but allows those with 20 or 25 years of service to buy-in privileges for the period between their early retirement and their Medicare eligibility.
- Create a Consensus Pension Benefit Review Group comprised of persons with specific pension and investment management experience to review and sign-off on any benefit enhancement proposal before it can be considered by the General Assembly.
- Require an actuarial analysis before any proposed pension benefit change may be considered by the Consensus Pension Benefit Review Group (if adopted) or a Legislative Committee or body.
- Given the purported breadth of Kentucky’s “inviolable contract”, require any proposed pension benefit enhancement to be introduced and considered in not less than two sessions of the Kentucky General Assembly before it can be enacted and become law.
- Unwind the “unescorted retiree” and “non-certified, part-time participation” issues.

Benefit consultant, Gabriel Roeder Smith & Company, presented the following recommendations to Work Group 2 following their analysis;

- Can create new tier with less expensive benefits, eligibility, and features within each plan to cover future New Entrants
- Eliminate the non-guaranteed COLA provision and replace it only with periodic GA-passed non-statutory ad hoc increases when funding is available.
- Create a lower-cost benefit tier for future New Entrants to KERS, CERS, and SPRS
- Create an optional lower-cost, second benefit tier for Current Active members, which incents participation by increased attractiveness by adding a “hybrid” feature (e.g., Cash Balance, DB/DC) to this tier or through the provision of a guaranteed COLA.

Work Group 2 concluded its last meeting on November 27<sup>th</sup> where all of the above listed recommendations were considered. Two motions were made before the group; Motion #1 called for doing away with the current guaranteed COLA (KRS only) and replace it with periodic GA-passed non-statutory ad hoc increases when funding is available. This motion was defeated.

The second motion before the Work Group called for doing away with the current guaranteed COLA provision (KRS only), and replace it with a statutorily guaranteed 1.5% and require its pre-funding. This motion was approved by the Work Group for passage to the full Blue Ribbon Commission.

With no apparent interest among the Work Group to further consider the recommendations for formal delivery to the Blue Ribbon Commission, Chairman Crall indicated that the COLA recommendation would be officially forwarded to the Commission and the other recommendations would be included in the report from the Work Group.

### **Work Group 3: Health (Medical) Insurance**

#### **Developing Sustainable Healthcare Plans and Benefits for Public Employees**

*Secretary Mark D. Birdwhistell, Chair*

In recent years, healthcare inflation has doubled the cost of medical insurance in the Commonwealth. While the magnitude of the increases has lessened most recently, costs continue to rise. Increased life expectancy and lower employee-to-retiree ratios have had a significant impact on the cost of post-employment benefits for employers across the nation, Kentucky included. This work group's goal is to develop recommendations to provide sustainable employment, and post-employment health benefits for current and future public employees.

#### **Background**

Medical insurance benefits for retired employees are offered through three separate public employee retirement systems. Retired teachers, age 65 and older, receive post-employment medical insurance benefits through the Kentucky Teachers Retirement System (KTRS), while retired state employees, 65 and older, receive medical insurance coverage through the Kentucky Retirement Systems (KRS). KRS is further comprised of the Kentucky Employees Retirement System (KERS), County Employee Retirement System (CERS), and the State Police Retirement System (SPRS). As a member, pre-65

retirees receive medical insurance benefits, funded by their retirement system, from the Kentucky Employees Health Plan (KEHP) which is a self-funded medical insurance program managed by the Commonwealth.

**Figure 3. Participants by System, May 3, 2007**

	<u>KTRS</u>	<u>KRS</u>	<u>KEHP</u>
Number of Members	Retirees – 16,186 Spouses/Adult Handicapped Children – 3,507 Total Participants – 19,693	Retirees – 25,924 Spouses/Adult Handicapped Children – 5,516 Total Participants – 31,440  <b>Members by System:</b> <b>KERS: 14,756</b>  CERS: 16,291 SPRS: 393 Total: 31,440 Waived Coverage: 12,000	Averages for January – June, 07 150,460 Planholders (109,982 Active; 386 COBRA; 40,091 Retiree)  24,460 KRS, 15,377 KTRS, 254 Other*  <b>92,874 Dependents ( 78,220 Active; 223 COBRA; 14,431 Retiree)</b> 10,089 KRS, 3,960 KTRS, 382 Other* 243,334 Participants (188,203 Active; 609 COBRA; 54,523 Retiree) 34,550 KRS, 19,337 KTRS, 636 Other* Other Retirees = Legislative, Judicial, KCTCS

KRS consists of three separate retirement systems: KERS, CERS, and SPRS. KTRS makes up the fourth retirement system. KERS and CERS are subdivided into non-hazardous and hazardous employees and have separate benefit structures. Each retirement system administers both a pension fund and an insurance fund which provides the beneficiary with a monthly retirement allowance and a retiree medical insurance benefit, respectively.

Work Group 3 initially focused attention on comparing, by each retirement system, the medical insurance benefits offered to members, both pre-65 and post-65 years of age. The intent was to identify areas of best practice or opportunities to create a synergy through enhanced coordination among the systems. While helpful, the benefit offerings for non-Medicare eligible versus those who are eligible were appropriately different and full, meaningful comparison between benefits was not

applicable. However, it was noted during several of the work group's meetings, that coordination of wellness and disease management programs, services and offerings, would be appropriate for consideration. This coordination would ensure necessary continuity for employees who may benefit from a coordinated strategy for wellness and disease management services throughout their active and post-employment involvement.

Understanding that the benefit design for the KEHP has implications on both the KRS and the KTRS for their pre-65 retirees, Work Group 3 concentrated efforts and discussion on consideration that could be made for the active plan. This included a comprehensive analysis of plan feature prevalence for the KEHP, as well as plan feature prevalence for plans in other states and not available to Commonwealth employees, retirees or dependents. Comparator information was pursued to determine relative values for various plan offerings and options, including using the 1994 Kentucky Kare Standard Plan as a benchmark comparator. This information provided a better understanding of the relative value of current plans, as compared to both current and historical plan offerings.

After considerable deliberation of the above information, Work Group 3 presented the following recommendations to be reviewed before the full Blue Ribbon Commission.

### **Work Group 3 Considerations and Recommendations**

#### **GRS Recommendations**

- Leverage current PPO platform into a High, Medium and Low option plan
- Collapse Enhanced & Premier plan into one plan
- Back into a plan design based on the inflation-adjusted 1994 premiums
- Establish three year planning horizon for benefit plan design
- Create “decision filters” for planning purposes; way points of strategic planning
- Implement a “spousal surcharge” on plans

- Audit claim administrator
- Audit Pharmacy Benefit Manager (PBM)
- Conduct a dependent audit
- Clarify “Kentucky Kare Standard” language in KRS 18A
- Refine Employer and Employee cost share calibration
- Further evaluate the cross-reference benefit and employee/employer cost-sharing
- Freeze dependent subsidy amount at 2008 levels
- Require participation of employees with “high cost” conditions in care/disease management programs
- Halt borrowing from the pension funds to pay for the cost of medical insurance
- Explore the possibility of developing a statewide provider network

## VII. RECOMMENDATIONS

### Recommendations on Financing

#### 1. Conduct an operational and a governance review of the investments.

- Use the Wilshire material as a model for areas of review
- Review operation for implementation of best practices
- An independent review of investments every three years by each system

**Action: PASSED by unanimous vote.**

#### 2. Phase in to the full ARC over not more than a 10 year period.

- Start with the 2008 contributions at the greater of the normal cost or the current year anticipated total contribution
- Increase 1/10th of the way in each subsequent year

*As amended.*

**Action: PASSED by unanimous vote.**

#### 3. Pre-fund part of the phase in using bonds if viable.

- After repaying KTRS for funds borrowed, always place the proceeds first into the insurance funds, so their ARC has a higher probability of being met
- Issue bonds only after a reexamination of current market conditions and risks
- An attempt to fund the ARC should accompany any bond issuance.

*As amended.*

**Action: PASSED with 1 (one) NO vote.**



**4. Recommend that the appropriate entities examine the funding policy to be used by KRS in calculating employer contribution rates for member agencies.**

*As amended.*

**Action: PASSED by unanimous vote.**

**5. Halt borrowing from the KTRS pension fund to pay for the cost of health insurance.**

**Action: PASSED by unanimous vote.**

### **Recommendations on Pension Benefits**

**6.a. The Kentucky General Assembly provide for COLAs based on the ability to pre-fund for same.**

*As amended.*

**Action: PASSED with 3 NO votes and 1 ABSTAINING.**

**6.b. Completely eliminate COLA provision from current KERS, CERS, & SPRS Systems.**

- Impacts both current active members and current retired members
- Future increases would need positive GA action to pass ad hoc COLAs, & each one must be funded
- By itself, does not reduce current DB contribution requirements but reduces how those costs will increase in the future

**Action: PASSED by roll call vote (9 YES, 7 NO, 1 ABSTAINING)**

**7.a. Create a lower-cost benefit tier for future new entrants KERS, CERS and SPRS that is a modified DB Plan.**

- No COLA
- DB Rule of 85 (min. 55)
- 1.00 factor no employee contribution
- DC mandatory (5% employee contribution, employer match 3%)
  - Limited access during or post employment
  - Consider requiring annuitization
  - Invest on in “Life cycle funds”

**Action: Chairman Crall deferred vote awaiting specific actuarial analysis.**

**7.b. The Legislature study strategies designed to extend the years of service for KERS, CERS, and SPRS including but not limited to: *see Fig. 4 below***

*As amended.*

**Action: PASSED by unanimous vote.**

**Fig. 4 Proposed Lower-Cost Benefit tier for Future New Entrants to KERS, CERS, & SPRS.**

PROVISION (1)	KERS & CERS NON-HAZARDOUS (2)	HAZARDOUS & SPRS (3)
Benefit Multiplier	1.75%	2.0%
Unreduced Retirement	65 & 5 or Rule of 85 w/ age 55 minimum	25 & out w/ Age 50 minimum
Reduced Retirement	55 & 5	50 & 15 (Same as current New Entrants)
Reduction for reduced Retirement	6.0% per year early	6.0% per year early

<b>New Entrant Employees to be covered</b>	Same as current New Entrants plus future New Entrants who do not qualify for new SPRS or Hazardous	Future New Entrants who actually perform duties as police officers or fire fighters
<b>Components of Compensation</b>	Excludes Unused Sick Leave payments and any lump sum payments or other terminal pay	Excludes Unused Sick Leave payments and any lump sum payments or other terminal pay
<b>Final Average Pay (FAE)</b>	5-year average (Same as current New Entrants)	5-year average
<b>Method for FAE Calculation</b>	Sum of compensation for highest 5 consecutive Plan (or Calendar) Years out of last 10 Plan (or Calendar) Years worked, divided by 5 for annual FAE	Sum of compensation for highest 5 consecutive Plan (or Calendar) Years out of last 10 Plan (or Calendar) Years worked, divided by 5 for annual FAE
<b>COLAs</b>	None promised. All would be funded ad hocs	None promised. All would be funded ad hocs
<b>Employee Contribution Rate</b>	6% of pay + 1% for retiree med	9% of pay + 1% for retiree med
<b>Interest on Employee Contribution Account</b>	2.5%, set by Board (but none on 1% retiree med contribution)	2.5%, set by Board (but none on 1% retiree med contribution)
<b>Pre-retirement death benefit provisions</b>	Same eligibility & amount as what current new hires have	Same eligibility & amount as what current new hires have
<b>Post-retirement lump sum death benefit</b>	Same as what current new hires have	Same as what current new hires have
<b>Disability benefit provisions</b>	Same eligibility & amount as what current new hires have	Same eligibility & amount as what current new hires have
<b>Unused Sick Leave</b>	Excluded from all calculations and eligibility features	Excluded from all calculations and eligibility features
<b>Service Purchase</b>	Full actuarial cost (including assumed future pay increases, earliest unreduced retirement date, and any	Full actuarial cost (including assumed future pay increases, earliest unreduced retirement date, and any automatic

	automatic COLA); excluded from all eligibility requirements	COLA); excluded from all eligibility requirements
<b>Eligibility for Retiree Medical</b>	Access-only if reduced retirement. Any applicable subsidy if unreduced retirement. None if a vested terminated participant beginning benefit at eligible retirement age.	Access-only if reduced retirement. Any applicable subsidy if unreduced retirement. None if a vested terminated participant beginning benefit at eligible retirement age.
<b>Return To Work After Retirement (RTW)</b>	After 12 months regardless of participating KRS,CERS, SPRS or KTRS employer or position, and regardless of whether full-time or part-time. No additional benefit earned. Employer contributes its applicable rates on RTW retirees' pay.	After 12 months regardless of participating KRS,CERS, SPRS or KTRS employer or position, and regardless of whether full-time or part-time. No additional benefit earned. Employer contributes its applicable rates on RTW retirees' pay.
<b>Rehire After Prior Termination</b>	Enters New Entrant tier	Enters New Entrant tier

## **Recommendations on Health Benefits**

### **8. Leverage current PPO platform into a Hi, Medium, Low option plan.**

- Greater differential between the Enhanced and Premier plans
- Adjust contribution for greater steerage

**Action: PASSED by unanimous vote.**

### **9. Collapse Enhanced & Premier plan into one plan.**

- Position at 1.01 to 1.04 in relation to 1994 plan
- Bring Essential plan up to .85 to .90
- Adjust contribution for greater steerage

**Action: PASSED with 2 NO votes.**

**10. Implement a “spousal surcharge.”**

- Addresses spouses that are eligible for benefits at their employer

**Action: PASSED with 2 NO votes.**

**11. Refine Employer and Employee cost share calibration.**

**Action: PASSED with 2 NO votes.**

**12. Further evaluate the cross-reference benefit employee/employer cost sharing.**

**Action: PASSED with 2 NO votes.**

**13. Freeze dependent subsidy amount at 2008 levels.**

**Action: PASSED with 3 NO votes.**

**14. Back into a plan design based on the inflation adjusted 1994 premiums.**

- Leverage the delta between the '94 inflation adjusted premiums and current premiums

**Action: Chairman Crall withdrew recommendation as not plausible.**

**15. Require participation of employees with “high cost” conditions in “care/disease management” programs.**

**Action: PASSED with 2 NO votes.**

**16. Explore the feasibility of separating CERS local government retirees from the Kentucky Employee Health Plan and providing them appropriate coverage.**

**Action: PASSED by unanimous vote.**

**17. As state employees, consider whether part-time school board workers now in CERS should be transferred to KERS and retain retiree health insurance coverage through the Kentucky Employees Health Plan and review the impact of unescorted retirees.**

*As amended.*

**Action: PASSED by unanimous vote.**

**18. Establish three year planning horizon for benefit plan design.**

- Make plan changes that will carry forward for most/all of that period

**Action: No action taken.**

**19. Create “decision filters” for planning purposes; way points of strategic planning.**

- Objective, measurable, repeatable statements
  - “KY per capita costs at X% of national average”
  - “KY trend factor at X% of national average”
- Helps to minimize plan “tweaking”
- Provides consistent basis for change

**Action: No action taken.**

**20. Audit claim administrator every 12 to 24 months.**

**Action: PASSED by unanimous vote.**

**21. Audit PBM every 12 to 24 months.**

- Not the same as a claim audit, this has a clinical component to it

**Action: PASSED by unanimous vote.**

**22. Conduct a dependent audit every 3 to 5 years.**

- Identifies ineligible dependents currently on the plans

**Action: PASSED by unanimous vote.**

**23. Explore the possibility of creating a statewide provider network.**

**Action: PASSED by unanimous vote.**

**24. Clarify the “Kentucky Kare Standard” language in KRS 18A.**

**Action: PASSED by roll call vote (11 Yes, 6 No)**

### **Recommendations on Governance**

**25. Create a Consensus Pension Benefit Review Group comprised of persons with specific pension and investment management experience to review and sign-off on any benefit enhancement proposal before it can be considered by the General Assembly.**

**Action: PASSED with 2 NO votes.**

**26. Require an actuarial analysis before any proposed pension benefit change may be considered by the Consensus Pension Benefit Review Group (if adopted) or a Legislative Committee or Body.**

**Action: PASSED by unanimous vote.**

**27. Given the purported breadth of Kentucky’s “inviolable contract”, require any proposed pension benefit enhancement to be introduced and considered in not less than two sessions of the Kentucky General Assembly before it can be enacted and become law.**

**Action: PASSED with 4 NO votes.**

**28. Require that two Governor appointed member positions of the KRS Board have extensive professional investment or other pension experience.**

*As amended.*

**Action: PASSED by unanimous vote.**

**29. Recommend a current Governor appointed member position be a local government administrative representative to the KRS Board.**

*As amended.*

**Action: PASSED with 2 NO votes.**



**30. Require investment and fiduciary training for all Board members of all pension systems.**

**Action: PASSED by unanimous vote.**

## **VIII. APPENDICES**

**(ENCLOSED ON DVD)**

### **A. Executive Orders**

### **B. Blue Ribbon Commission Meetings**

#### **Blue Ribbon Commission Meetings**

##### **April 16, 2007**

Agenda  
Meeting Minutes

##### **May 14, 2007**

Agenda  
Meeting Minutes  
Presentations  
*KRS Overview – William Hanes*  
*KTRS Overview – Gary Harbin*  
Video

##### **June 19, 2007**

Agenda  
Meeting Minutes  
Presentations  
*KY School Board Association –Alicia Sells*  
*KY League of Cities – Sylvia Lovely*  
*KY Association of Counties –Bob Arnold*  
*Office of State Budget Director – John Hicks*  
Video

##### **August 28, 2007**

Agenda  
Meeting Minutes  
Presentations  
*Pension Obligation Bonds – F. Thomas Howard*  
Video

##### **September 25, 2007**

Agenda  
Meeting Minutes  
Presentations  
*Legal Report to the Blue Ribbon Commission – Morrison & Foerster LLP*  
Video

##### **October 31, 2007**

Agenda  
Meeting Minutes  
Presentations  
Summaries of work to date:  
*KRS Overview – William Hanes*  
*KTRS Overview – Gary Harbin*

*KY Public Employees' Deferred Compensation Authority – Robert Brown*  
*Managing Retiree Medical (and other OPEB) Liabilities; UAAL and Discount Rate Assumptions – Gabriel, Roeder and Smith Co.*  
*Pre-65 Health Insurance –Chris Corbin and Christine Wilcoxsin*

Video

**December 6, 2007**

Agenda

Meeting Minutes

Presentation

*Recommendations from Work Groups –Gabriel, Roeder and Smith Co. (GRS)*

Video

**December 18, 2007**

Agenda

Meeting Minutes

Presentations

*Vote on recommendations presented to commission members*

Video

**Work Group 1 Meetings – Financing Strategy**

**June 12, 2007**

Agenda

Meeting Minutes

Presentations

*Fundamental concept actuarial accounting – Cavanaugh and MacDonald*  
*KRS – Tom Cavanaugh*  
*KTRS – Ed MacDonald*

**July 25, 2007**

Agenda

Meeting Minutes

Presentations

*New GASB Rule –Cavanaugh and MacDonald*  
*KRS Health Fund – Tom Cavanaugh*  
*KTRS Health Fund – Ed MacDonald*

**September 25, 2007**

Agenda

Meeting Minutes

Presentations

*Report from Actuarial and Benefits Consultant – Gabriel, Roeder and Smith Co. (GRS)*

**November 8, 2007**

Agenda

Meeting Minutes

Presentations

*Report from Actuarial and Benefits Consultant – Gabriel, Roeder and Smith Co. (GRS)*

**December 3, 2007**

Agenda

Meeting Minutes

Presentations

*Recommendations from Actuarial and Benefits Consultant – Gabriel, Roeder and Smith Co. (GRS) and Wilshire Co.  
Summary of Investment Strategy –KRS and KTRS*

**Work Group 2 Meetings – Pensions**

**May 2, 2007**

Agenda

Meeting Minutes

Presentations

*KTRS – Jane Gilbert*

**July 11, 2007**

Agenda

Meeting Minutes

Presentations

*Current Pension Benefits -KRS – Williams Hanes  
Current Pension Benefits -KTRS – Gary Harbin*

**August 28, 2007**

Agenda

Meeting Minutes

Presentations

*Current Benefits made available to State Employees from Deferred Compensation Authority– Robert Brown  
Coalition for Sustainable Benefits  
Report from Actuarial and Benefits Consultant – Gabriel, Roeder and Smith Co. (GRS)*

**September 25, 2007**

Agenda

Meeting Minutes

Presentations

*Pension Benefits and Options -GRS*

**November 8, 2007**

Agenda

Meeting Minutes

Presentations

*Summary of Pension Benefits for Kentucky Plans  
Starting Points for Pension Benefits for New Entrants to Kentucky Plans*

**November 27, 2007**

Agenda

Meeting Minutes

Presentations

*Alternatives for Kentucky Defined Benefit Plans*

## **Work Group 3 Meetings – Health Insurance**

### **May 7, 2007**

Agenda  
Meeting Minutes  
Presentations  
*BRC Working Group 3 Overview*

### **June 4, 2007**

Agenda  
Meeting Minutes  
Presentations  
*KRS Retiree Health Plan Table*  
*KTRS Retiree Health Plan Table*  
*Medicare Claims Payment with Wausa Benefits*  
*Medicare Prescription Drug Benefit*  
*Medicare Modernization Act and its Effect on Retiree Benefits*

### **August 3, 2007**

Agenda  
Meeting Minutes  
Presentations  
*KEHP Retiree Health Plan Table*  
*Plan Benefits Comparison Table*

### **September 25, 2007**

Agenda  
Meeting Minutes  
Presentations  
*Health Benefits Plan Comparison*

### **November 16, 2007**

Agenda  
Meeting Minutes  
Presentations  
*Plan Comparison, Prevalence Data and Relative Value Analysis*

### **November 29, 2007**

Agenda  
Meeting Minutes  
Presentations  
*Kentucky Benefits vs. Others*  
*Observations and Recommendations*

- C. Inviolable Contract: Legal Report to the Blue Ribbon Commission (Morrison & Foerster LLP)**
- D. GAO Report on State and Local Government Pensions, September 24, 2007**
- E. Letters to the Blue Ribbon Commission**

**– END –**